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“Online infringement of copyright (initial obligation) cost-sharing” – consultation by the Department of Business Innovation and Skills

Response from the Mobile Broadband Group

The Mobile Broadband Group (MBG, whose members are the UK businesses of O2, Three, Vodafone and Everything Everywhere [which operates the businesses of T-Mobile and Orange in the UK]) welcomes the opportunity to respond to the Government’s consultation on cost sharing with respect to the Initial Obligations Code arising from the Digital Economy Act.

Question 1

Is the list of included cost items correct? What items should be added or removed? Please give reasons.

The context for this assessment is that the activities required of the ISPs by the code are unrelated to their own business. The time taken up with servicing the notifications process will divert scarce time and resources away from the key activity of ISPs serving their customers. As Mott McDonald stated in their report, there is a high opportunity cost to serving the code, which the consultation document suggests should not be included in ‘eligible costs’ other than a small uplift to recognise their existence. The rationale for excluding the majority of these costs is that it is too difficult in practice to quantify them and, in any event, their exclusion will create an incentive for ISPs to minimise their costs and not undertake greater development work than is justified. We are not persuaded by these arguments.¹ Mobile operators are not seeking to inflate costs or make a profit from this

¹ Whilst the MBG recognises the practical difficulties in assessing such costs, there clearly are methodologies that could be employed to assess the impact (for example, assessing the business impact of re-prioritising business projects on roadmaps for the year). As Mott McDonald say, these

process nor do we agree that some measures of loss are “impossible” to quantify². We are, of course, content that there is an independent examination of efficiently incurred costs by Ofcom, so that all stakeholders can be confident that costs are not inflated.

It is only right that all costs efficiently incurred by ISPs in support of the code are fully assessed and properly reflected in what is recoverable. Such costs should include both capital expenditure and operating expenditure.

In addition to the costs identified in the Statutory Instrument, there are further items of expenditure where it should be absolutely clear that they are included:

a) Costs of processing and storing data

As the MBG has explained in response to the original BIS consultation on file sharing, because of a very limited supply of IP addresses (depending on exact architecture), the mobile operators share their public IP addresses amongst their customers on a dynamic basis. This dynamic process uses a network port address translation function, which allows many thousand private IP addresses to share a limited number of public IP addresses. As far as nodes in the Internet are concerned, hundreds of mobile customers often appear as a single public IP address. This process is dynamic as a subscriber will use a new public IP address every time they use a new application, connect to a new web page, or a new destination. The unique identifier is the TCP or UDP port number which indicates the application used and is generated by the source and destination systems to manage the transfer of data. The process of connecting the private IP address used by a subscriber to the public IP address used at a point in time is called “mapping” or “natting”.

Mobile operators do not currently store “mapping”/“natting” data for any length of time, as there is no business or regulatory requirement to do so.

In order to identify an individual from a CIR, a mobile operator must collect and store the natting data (which maps private to public IP addresses) in a standardised format, match this information to a phone number, and to a name and address where such information is available.

costs clearly do exist and there are bottlenecks. And in any event, some assessment is presumably to be made in order to determine the uplift that Mott proposes.

² The risk of loss of business to ISPs as a result of these measures has been generally recognised. An ISP which sought to profit from the arrangement would only likely compound this risk. Indeed for a mobile operator (or indeed any ISP with bundled “multiple” play offerings), a fixed broadband customer may well also be a mobile customer. Accordingly, the cost of a loss of a customer can be far greater than the loss of just fixed broadband revenue (if indeed there is a broadband revenue stream in the first place – given the popularity of “free” broadband offers) along with the cost of replacing the customer. Given that average revenues per user and average acquisition costs are fundamental measures in the industry, we do not agree that they are “Impossible” to quantify.

Implementation of the Code would involve the storage of massive amounts of data at a high cost. The costs of collecting, analysing, storing and matching this information must be recovered and explicitly referred to within the SI.

b) Costs of capital

The capital expenditure for storing the “natting” data will have to be carried out in advance of any mobile operator being able to respond to a CIR. The costs of financing this system must therefore be calculated and included within the costs of sending a CIR. The expenditure is also for a dead asset that may not have any other useful function.

c) Appeals

An ISP should only be required to produce a confirmation that they have followed an accredited process to identify the subscriber that is appealing. The cost of producing this statement should be covered by the copyright owner whose work has apparently been infringed by the subscriber

d) Information requests from Ofcom

Ofcom have rights to make formal information requests in pursuit of their duties under Act. The administration of responding to such requests can be very time consuming. These costs should also be included.

e) Accreditation costs

Ofcom have indicated in discussion that the most efficient way of handling CIRs in a manner that can be relied upon by all stakeholders is for each ISP to have its matching and notification process accredited. Should this turn out to be the case, accreditation and compliance costs should also be included.

f) Other costs which ISPs incur in meeting their obligations

It is helpful in the consultation to list the main “eligible” costs. Nevertheless, care needs to be taken against being over prescriptive and thus risk excluding costs that an ISP legitimately incurs in meeting its obligations under the Code but which do not appear to fall within any prescriptive “eligible list”. For example, the list only mentions storage of CIRs yet, as we explain above, there will be other retention requirements under the Code, for example, storage of notifications sent and records thereto. Furthermore, ISPs are likely to have to answer questions about CIRs that have been received. Indeed the list is described as the “main” cost elements. By definition the list is not exhaustive and there will be other legitimate costs incurred.

Accordingly, we believe, any SI must provide for the inclusion of all costs that an ISP legitimately incurs in relation to the Code and as a result of meeting its obligations under the Code (subject to defined excluded costs). This is not to seek to extend the eligible list

exhaustively but rather to ensure that legitimate costs are not found to be technically outside the scope of what is recoverable.

Care will also have to be exercised to ensure that the SI does not cut across or negate the Indemnity that ISPs are entitled to receive from CROs against claims/ actions. i.e. if legal costs aren't specifically mentioned in the eligible list but are mentioned in the excluded list.

Question 2

Do you think this is the right approach to the sharing of notification costs? If not, what should it be? Please give reasons and any supporting evidence

As the MBG explained in response to question 1, the problem for mobile ISPs is that a large proportion of the total costs are the capital costs that must be incurred in advance. While the flat fee per CIR, based on copyright owners' forecasts, is perhaps the easiest way to calculate the amount payable, it does not account for the cash flow aspects or the fact that mobile ISPs have no guarantee that that initial capital costs will be recovered, in the event that not enough CIRs are sent through to recover the cost.

If mobile ISPs are to be required to build the necessary infrastructure, then the copyright owners that wish to send CIRs must pay in advance for their forecast and the forecast should be sufficiently accurate to recover efficiently incurred capital expenditure.

The MBG does not agree with BIS's reasoning for imposing a share of the costs on ISPs.

First, the efficiently incurred costs are to be independently determined by Ofcom and so the incentive to administer the process efficiently is not relevant to the value arrived at by Ofcom. Whatever the value of the fee or the proportion of cost recovered, the ISP is still incentivised to run their business efficiently.

Secondly, ISPs will also still have incentives to negotiate innovative revenue sharing or distribution deals on content and, indeed, have a good track record of doing so.

Thirdly, the opportunity cost to mobile operators of diverting scarce resources away from non-business generating activity into this non-business (from the ISP's perspective) activity is, under these proposals, not being recovered. This is sufficient penalisation without then adding a portion of the notification costs as well.

There is a further point to consider.

While capex for developing systems for large ISPS could be higher, it is likely there will be economies of scale from processing CIR's. Processing 5,000 CIRs per week could easily be less costly (per CIR) than processing 1,000 per week. If Ofcom decide to deal with only the top 4 ISPs, then the 'cost' should be the efficiently incurred costs of the 4th largest operator, applied to all ISPs. If they decide to run with the top 40, then the cost per CIR should be set at the efficiently incurred costs of the 40th largest operator, either applied across the board or applied in a way that takes advantage of the ability to set different costs per CIR for

different categories. This will have to be done sensitively because not only will there be differences between fixed and mobile ISPs but also in efficiently incurred costs from ISP to ISP, depending on architecture and other factors.

Question 3

Do you think the 75:25 ratio is the correct one? If not, what should it be? Please give reasons and any supporting evidence

As has been pointed out above and was pointed out several times during the parliamentary debates on the relevant clauses in the Digital Economy Act, there is no basis for the ISPs bearing any proportion of the costs.

We therefore disagree with the Government's approach to cost apportionment. Copyright owners are the beneficiaries of this activity and they (not ISPs) should meet all the ISPs' network and other costs. The Better Regulation Principles of the Cabinet Office require that the costs of regulation on business as a whole should be kept to a minimum and be proportionate to the desired outcome. Ofcom's own "6 principles of pricing and cost recovery" embody both that of cost causation and distribution of benefits. Therefore it is clear that copyright owners, as the only beneficiary of this activity, should meet all ISPs' network and other costs. Mobile operators do not promote illegal file sharing nor financially benefit from it, yet they are being asked to cover the costs of enforcement. The Government has never provided solid arguments for requiring ISPs to bear some of the costs. Paragraph 5.8 of the consultation argues that ISPs should bear some of the costs for the following reasons:

- a) it gives them an incentive to minimise the cost of sending notifications
- b) it provides incentives to take voluntary measures to reduce online copyright infringement
- c) it provides incentives to participate in commercial offers under which a bilateral agreement could reduce the numbers of notifications they receive

These arguments do not hold true for mobile ISPs:

- a) As we have explained above, the majority of mobile ISPs' costs come from the need to build infrastructure to link public IP addresses to allocated private IP addresses and to store this routing information. It is in the commercial interests of the mobile ISPs to design and implement the most efficient processes to achieve this.
- b) Voluntary measures are already being taken by mobile operators to prevent file sharing growing and operators have actively negotiated with rights holders on new legal content. We apply a fair use policy and some mobile ISPs may also apply to traffic management for P2P traffic at busy times to allow other users access to the network. We note the later phrasing of this

point in the impact assessment which states that costs should be shared to *“ensure that ISPs have incentives to reduce the number of instances of online copyright infringement”*. The current provisions do not address this stated aim, as imposing a new costs burden on a party which has no such obligation is not any sort of “incentive”, instead it penalises a neutral party for the unknown acts of its subscribers.

c) Mobile platforms have developed very differently to fixed online platforms and there has been considerable growth in legitimate content such as music, games and video clips which compete successfully against piracy based alternatives. Ofcom’s Communications Market Report 2009 states that the mobile platform continues to play an important role in stimulating digital music sales with a third of all digital music purchases being made over a mobile devices due to services such as T-Mobile’s Jukebox, Nokia Comes with Music and applications on the G1 and iPhone which link to legitimate content. Mobile operators do not promote illegal file sharing or derive any direct financial benefit from it, yet we are being asked to cover the costs of enforcement³.

It therefore follows that the ISPs should not be obliged to contribute to any of the costs that Ofcom may incur in both setting up the new regime and in maintaining it. ISPs should not similarly be required to contribute to the costs of an appeals body as their participation in an appeals process should be limited as described above. ISPs already pay substantial regulatory fees to Ofcom and there is no rationale for or basis on which they should be paying further fees to handle issues solely related to P2P file sharing.

In conclusion, there should be no sharing of costs; copyright owners should be required to cover all of Ofcom’s cost, the costs of setting up and appeals body and the costs of the ISPs who are now obliged to perform an essentially administrative role on their behalf. This entire new enforcement process has been set up to serve the interests of the copyright owners in protecting their core business models. There is no objective justification for ISPs, as mere conduits in the provision of access to the internet, being obliged to bear the burden of enforcing someone else’s legal rights.

Moreover, if the measures are successful, the costs that copyright owners incur can be regarded as worthwhile investment that will have a return on capital derived from the increase in legitimate sales (they cannot argue that piracy damages sales and ignore the reverse impact).

³ Indeed, any transfer of the costs of enforcing rights to ISPs actually reduces the incentive on Rights Owners to negotiate new models and to migrate away from expired business models. The very actions which are recognised as being the true long term solution to the issue. Also, as above, if they do not meet the full attributable costs, there is a subsidy from ISPs to rights owners. This is economically inefficient and distortive.

Question 4

Do you think this is reasonable? Do you have an alternative formulation that addresses the issue in a more effective way? Please give reasons.

Notwithstanding our position that ISPs should not be required to contribute to, and therefore be concerned with, Ofcom's costs, we would suggest that the UK government transparently reviews the list of activities included in the set up costs of the French Government's estimate for setting up the HADOPI process, which seem high.

Question 5

Do you think the broad 75:25 cost split should be used to apportion the cost of the regulator functions and appeals? If not, why not and how should they be funded?

We believe the copyright owners should bear the costs of establishing and administering the system and appeals. The MBG has suggested to Ofcom (and Ofcom seems already to be thinking along such lines) that ISPs processes for matching IP addresses to subscribers should be accredited. The ISPs are a mere conduit to the internet and should have no obligation to assert the rights of copyright owners otherwise than to follow an accredited process to identify an individual from an IP addresses. If the process produces the wrong result, the process is at fault and not the ISP. The notification process will be completely untenable if the ISP's processes are to be constantly capable of appeal, challenge and therefore, revision.

Question 6

Should subscribers have to pay a fee to access the appeals system? If so, at what level, and how should economically vulnerable people be protected? Please give reasons and any supporting evidence.

ISPs should have a limited role in any appeals process, confined to a confirmation that their accredited processes have been followed in the case at hand. With this in mind, we don't consider it appropriate to comment in detail on issues that will not directly impact ISPs themselves. However, as our customers will be involved in these proceedings, we would urge the other parties involved to ensure that our customers are treated fairly and have access to justice.

Question 7

Does the Order achieve all of these objectives? If not, please specify which aim(s) you feel the Order fails to achieve and why.

The draft order does not provide mobile operators with any certainty over their cost exposure in the short or medium term.

As mentioned above mobile operators will need to invest significant sums upfront and as currently drafted the SI does not require copyright owners to commit to a minimum number of notification requests. This is a fundamental omission and must be corrected. Without a

commitment to forecast and pay up front for enough CIRs to meet the investment costs, there is a real risk that mobile operators who meet the minimum threshold and invest in systems never fully recover their costs.

Specifically,

- s.4(2)(b) does not include the mobile ISP's costs of matching a public to a private IP address, where necessary, and the costs of storing the relevant data. This section should therefore be amended;
- s.4(2)(g) mentions that ISPs shall incur the costs of answering subscriber queries. It is our strong view that the copyright owners should bear that cost, so that all notifications direct subscribers to resources maintained by the copyright owners. This section should therefore be deleted;
- s.4(4)(b) describes the current 72:25 split as suggested, which must be amended to state that the copyright owners shall pay 100% of the ISP's costs. Here (as in s, 6(2) later), it must also be clear that an ISP incurs costs once it receives a CIR for processing, not simply once a notification is sent;
- s.5(1) and (2), 6(4) and 7 should be amended to make it clear that ISPs are not required to pay a share of the costs detailed in this section; and
- The SI needs to be amended to make clear there is no obligation on ISPs to process CIRs that exceed a copyright owner's forecast.
- Clauses 4 and 6 in the SI refers to notification costs. This is an incorrect term and implies that ISPs will only recover costs from successful notifications rather than from all CIRs that they process. The MBG suggests this is replaced by "CIR costs". Likewise paragraph 3.2 of the consultation document states that "*However rights holders will be charged a standard flat fee for each notification they send to an ISP*". This should refer to "each CIR" sent rather than "each notification".

Question 8

If you answered "no" to Question 6, please set out how you think the Order should be changed.

n/a

Question 9

Do you agree with the process that the Order establishes in terms of when copyright owners may participate?

n/a

Question 10

Does this process ensure that small copyright owners are able to access the system? If not, what alternative provisions could be made?

Yes. The process allows Trade Associations to act on behalf of small copyright owners such as BPI for music and the Federation of Software Games. All copyright owners must comply with the standards agreed in the initial obligations code or this will give rise to additional ISP costs in having to support multiple systems and appeals arising from lower standards of evidence.

A minimum threshold based on the percentage of notifications received needs to be agreed to ensure the process does not discriminate against smaller ISPs.

Question 11

The impact assessment sets out the costs as we understand them at this stage. Does this represent a reasonable assessment of the position? Please provide any supporting evidence for your comments.

The impact assessment focuses on the cost allocation. We challenge the suggestion that the overall effect of being required to share the costs of this new system is “neutral” for ISPs. We are not currently obliged by any law or regulatory body to store and process the information which we will now be obliged to do. We derive no other commercial benefit from this new obligation, so there is no benefit to balance or outweigh these costs. We therefore find these sweeping assumptions to be entirely without foundation.

We note the figures given in table 1 and we assume that the copyright owners will be grateful for the estimate of the annual costs of running a call centre that we strongly believe they, and not ISPs, should be obliged to provide to subscribers.

We note that nowhere in the “benefits” section of this document is there a cost/benefit analysis of all the multi-million pound costs of this new regime versus the reported losses to the copyright holders as a result of illegal file sharing.